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In The

Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC.,

Petitioner,

v.

FRANCISCO J. ESPINOSA,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICUS CURIAE* NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC., IN SUPPORT OF PETITIONER, UNITED STUDENT AID FUNDS, INC.

STEVEN L. THOMAS, ESQ. WVSB#3738
KAY CASTO & CHANEY PLLC
Post Office Box 2031
Charleston, West Virginia 25237-2031
(304) 345-8900
Counsel for Amicus Curiae

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

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The National Council of Higher Education Loan Programs, Inc. ("NCHELP") respectfully files this brief in support of Petitioner, United Student Aid Funds, Inc.[1]

STATEMENT OF INTEREST OF *AMICUS CURIAE*

NCHELP is the largest student loan trade association, representing a nationwide network of guaranty agencies, secondary markets, lenders, loan servicers, collectors, schools and other organizations that provide financial assistance to millions of American students and their families each year through the Federal Family Education Loan Program (the "FFELP"). The FFELP is a guaranteed student loan program that has helped over 60 million students obtain a post-secondary education since its establishment by Congress as part of the Higher Education Act of 1965 (codified at 20 U.S.C. §1071 *et seq.*). As described in the President's fiscal year

[1] Pursuant to Sup. Ct. R. 37.6, NCHELP states that no counsel for a party authored this brief in whole or in part, and no person other than NCHELP has made a monetary contribution to the preparation or submission of this brief (recognizing that NCHELP is a trade association and its activities are funded by membership dues and assessments). All parties have consented to the filing of this brief by NCHELP, and their consent letters are on file with the Clerk's Office. Counsel of record for all parties received notice at least ten (10) days prior to the due date of NCHELP's intention to file this brief.

2010 budget, the outstanding balance of FFELP guaranteed student loans was $413 Billion as of September 30, 2008. Administering the FFELP is a complex endeavor, which is the subject of detailed regulations promulgated by the United States Department of Education (the "Department").

By regulation, the Department tasks FFELP lenders and guaranty agencies with responsibility for taking specific actions after a bankruptcy case is commenced by a student loan debtor. These applicable regulations are found at 34 C.F.R. §682.402. When a FFELP borrower simultaneously files a chapter 13[2] bankruptcy petition and plan without contemporaneously filing an adversary proceeding seeking a determination of undue hardship, the lender is required to file a bankruptcy claim with the guaranty agency within 30 days of the date it receives notice of the first meeting of creditors. 34 C.F.R. §682.402(g)(2). The guaranty agency then is required to participate in the bankruptcy case, as detailed in 34 C.F.R. §682.402(i).

Because the FFELP operates nationwide, lenders receive bankruptcy notices from all 94 judicial districts in the United States. When lenders file bankruptcy claims with guaranty agencies, the guaranty agencies then are confronted with a huge logistical problem: there is no national form of

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[2] Chapter 13 of the United States Bankruptcy Code, 11 U.S.C. §1301 *et seq.* (the "Bankruptcy Code" or "Code").

chapter 13 plan. As guaranty agencies receive at least 94 different forms of chapter 13 plan, the Ninth Circuit's holding will lead zealous debtors' counsel to seek to gain an unfair advantage by burying improper "discharge by declaration" language in chapter 13 plans. The Ninth Circuit's endorsement of discharge by declaration would force guaranty agencies to hire additional staff to scrutinize every chapter 13 plan for language which has no foundation under the Bankruptcy Code. Given the extraordinarily short deadline for lodging objections to confirmation in chapter 13 cases, a certain number of chapter 13 plans with illegal language are bound to escape detection.

In fact, given the current statutory time frame for the plan confirmation hearing (Code §1324(b)), the deadline for objections to plan confirmation may expire before the guaranty agency can process the lender's bankruptcy claim. *See In re Foster,* Case No. 09-30603 (Bankr. S.D. W.Va. 2009). (Chapter 13 petition and plan both filed on Friday, August 7, 2009; notice of creditors meeting issued on August 10, 2009, establishing September 14, 2009 deadline for objections to confirmation.)[3] If the chapter 13 plan in such a case includes "discharge by declaration" language, the result ordained by the Ninth Circuit literally imposes an impossible burden on NCHELP's member

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[3] These dates appear on the court's electronic docket, accessible through the ECF system.

guaranty agencies (allowing time for delivery by standard mail and 30 days for the lender to file its bankruptcy claim).

Due to the intractable practical implications of the Ninth Circuit's endorsement of "discharge by declaration", NCHELP requests this Court to consider this *Amicus* brief on behalf of its constituent guaranty agencies.

STATEMENT OF THE CASE

Effective November 5, 1990, 11 U.S.C. §1328(a) was amended by the Student Loan Default Prevention Initiative Act of 1990 (Pub. L. No. 101-508, §3007 (1990)) to make student loan debts described in 11 U.S.C. §523(a)(8) nondischargeable in chapter 13 cases. Less than two months later, Doreen Andersen commenced the age of "discharge by declaration" in chapter 13 practice. On December 27, 1990, Ms. Anderson filed her chapter 13 petition and plan containing the following provisions:

> All timely filed and allowed unsecured claims, including the claims of Higher Education Assistance Foundation . . . which are government guaranteed education loans, shall be paid ten percent (10%) of each claim, and the balance of each claim shall be discharged. Pursuant to 11 U.S.C. §523(a)(8), excepting the aforementioned education loans from discharge will impose an undue hardship on the debtor and the debtor's

> dependents. Confirmation of debtor's plan shall constitute a finding to that effect and that said debt is discharged.

The Higher Education Assistance Foundation ("HEAF"), the responsible guaranty agency, filed an untimely objection to the plan, which was denied for that reason. *Andersen v. UNIPAC-NEBHELP*, 179 F.3d 1253, 1254 (10th Cir. 1999), overruled by *Educational Credit Management Corp. v. Mersmann (In re Mersmann)*, 505 F.3d 1033 (10th Cir. 2007).

On December 7, 1992 (while Doreen Andersen was still performing her chapter 13 plan), Francisco Espinosa filed his chapter 13 petition and plan. Mr. Espinosa's bankruptcy schedules listed as his only debt the student loans held by United Student Aid Funds, Inc. ("USA Funds"). Thus, Espinosa's chapter 13 plan was an artifice for a surgical attack on his student loan debt, under cover of a generic pleading.

Espinosa's plan proposed to pay only the principal amount of his student loans, unilaterally declaring that "amounts claimed by [USA Funds] for capitalized interest, penalties, and fees shall not be paid for the reasons that the same are penalties and not provided for in the loan agreement between the debtor and the lender. Any amounts or claims for student loans unpaid by this Plan shall be discharged." Espinosa's plan did not contain any language declaring that repayment of such amounts would constitute undue hardship.

Even though USA Funds' claim was the only debt addressed in the plan, and the plan effected a unilateral resolution of an evidentiary dispute, the caption of Espinosa's plan did not evince his intent to adjudicate a dispute with USA Funds. Instead, the plan merely recited a generic warning statement that the rights of creditors may be impaired. Espinosa did not mail his plan to USA Funds' agent for service of process, but instead to the address maintained by USA Funds to receive loan payments. Thus, Espinosa's plan did not fit the form prescribed for resolution of an evidentiary dispute (an adversary proceeding pursuant to Rule 7003 of the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rule(s)" or "Rule(s)")) and was not served on an appropriate agent pursuant to Bankruptcy Rule 7004(b)(3).

USA Funds responded to the notice of Espinosa's bankruptcy case by doing the only thing it was required to do by the Bankruptcy Code and Rules: it timely filed a proof of claim.[4] In 1992 (and today) nothing in the Bankruptcy Code or Rules provides a good faith basis for chapter 13 debtors to insert "discharge by declaration" language into their plans. However, Bankruptcy Code §502(a)(1) specifically provides that a timely filed proof of claim is deemed allowed. Espinosa did not file an objection to USA

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[4] As Espinosa had defaulted on his student loans prepetition, his notes were held by USA Funds when the bankruptcy case was commended.

Funds' proof of claim and no order was entered by the bankruptcy court disallowing any portion of such claim.

USA Funds did not file an objection to confirmation of the plan. On May 6, 1993, the bankruptcy court entered a form Order Confirming chapter 13 Plan, containing an incantation that "[t]he Plan has been proposed, and its acceptance procured, in good faith and not by any means, promises or acts forbidden by law." The court made this finding despite the fact that (i) Espinosa's plan provided for the discharge of a portion of his student loans without an adjudication of undue hardship, a concept which has no foundation under the Bankruptcy Code or Rules; (ii) the caption of Espinosa's plan did not evince his intent to adjudicate an evidentiary dispute with USA Funds, despite the fact that its claims were the only debts addressed in his plan; and (iii) Espinosa did not serve his plan on USA Funds' agent for service of process, but instead mailed the plan to its general address for receipt of payments. The bankruptcy court's order did not contain any finding of undue hardship.

After the bankruptcy court Order Confirming chapter 13 Plan had become final and non-appealable under Bankruptcy Rule 8002, on June 10, 1992, the chapter 13 trustee mailed a pleading captioned "Trustee's Notice To Creditor" to USA Funds' address for receipt of payments. The "Trustee's Notice To Creditor" is a fugitive pleading; it has no foundation under the Bankruptcy Code and Rules. *See, e.g.*,

FED. R. BANKR. P. 7003 and 9014. USA Funds did not respond to the "Trustee's Notice To Creditor."

Espinosa performed his plan as proposed and the bankruptcy court entered a form discharge order on May 30, 1997, generally discharging all debts provided for by the plan, specifically excepting student loans from this discharge. Espinosa did not appeal from the entry of that order.

In 2000, collection efforts resumed. On June 23, 2003, Mr. Espinosa filed a motion to reopen his case and, on October 2, 2003, he filed a motion for violation of the discharge injunction, contempt, sanctions and damages. On October 30, 2003, USA Funds filed a response to Espinosa's motion, together with a cross motion for relief from the confirmation order pursuant to Federal Rule of Civil Procedure ("FRCP") 60(b)(4) and Bankruptcy Rule 9024. On August 12, 2004, the bankruptcy court entered an order finding that the discharge injunction had been violated, but denying the Debtor's request for contempt, sanctions and damages. On appeal, the district court reversed, holding that the confirmation order was void for lack of due process due to the absence of an adversary proceeding.

When this case reached the Ninth Circuit, that court first remanded the matter to the bankruptcy court to answer the question whether the original discharge order (which provided that Espinosa's student loan debt had not been discharged) was the result of a clerical error. The bankruptcy court ruled

that a clerical error had occurred and entered an order discharging Mr. Espinosa's student loan obligations. The Ninth Circuit then reversed the district court and remanded the case to the bankruptcy court for reinstatement of the order enforcing the discharge injunction and for a determination whether USA Funds acted willfully in violating the injunction. *Espinosa v. United Student Aid Funds, Inc.* (*In re Espinosa*), 553 F.3d 1193, 1205 (9th Cir. 2008).

SUMMARY OF ARGUMENT

The Bankruptcy Code gives debtors extraordinary powers to reorder contract rights among and between themselves and their creditors, provided that creditors are afforded notice and opportunity for a hearing. Bankruptcy Code §102(1) explains that this phrase means after such notice as is appropriate in the particular circumstances and such opportunity for a hearing as is appropriate in the particular circumstances. This is the Bankruptcy Code's due process mission statement.

The Bankruptcy Code itself never specifies what process is due in any particular circumstance. Instead, in 28 U.S.C. §2075, Congress gave this Court "the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under Title 11." In promulgating the Bankruptcy Rules, this Court

broadly distinguished between matters requiring general notice (those affecting general administration of bankruptcy cases and all creditors generally, but none specifically), and matters requiring service of process (those implicating the rights of specific parties). Bankruptcy Rule 2002 articulates the manner of giving general notice and includes the time for filing objections to confirmation of a chapter 13 plan. Bankruptcy Rules 7001 governs notice where the rights of specific parties are in dispute and includes proceedings to determine dischargeability of a debt. Rule 7001 requires the dispute to be properly framed by summons and complaint with service upon an authorized agent.

The exception of student loans from discharge is self-executing. Debtors must affirmatively secure a hardship determination. Thus, the Bankruptcy Code does not provide a good faith basis for "discharge by declaration" language in chapter 13 plans.

Hundreds of thousands of chapter 13 cases are commenced every year. The Bankruptcy Code and Rules implement a true "rocket docket" to cope with this deluge of cases. However, there is no national form of chapter 13 plan. Given the pervasive nature of the FFELP, student loan guaranty agencies receive a cornucopia of forms of chapter 13 plans from the 94 judicial districts in the United States, with an arbitrarily short period of time to respond. In fact, given the nature of chapter 13 practice, the deadline for objections to plan confirmation can actually expire before the guaranty agency receives the chapter 13

plan. Student loan guaranty agencies do not receive notice of "discharge by declaration" plan language in a reasonable form within a reasonable time to actually participate in chapter 13 bankruptcy cases.

The Ninth Circuit's analysis of this issue conflates the concepts of "service" and "notice" under the Bankruptcy Rules. Service connotes a summons and complaint which properly frames the issue, which is served on an authorized agent. Chapter 13 plans with concealed "discharge by declaration" language which are mailed to student loan lockboxes flout this principle.

The Ninth Circuit compounds this error by equating actual notice that a chapter 13 plan has been filed with actual notice that the plan contains improper "discharge by declaration" language. Holders of nondischargeable claims generally have no duty to actually read plans. The most economical way to administer the FFELP is to file a proof of claim, accept whatever distribution is forthcoming under the plan, and resume collection after the case is concluded.

Finally and most critically, the Ninth Circuit errs by failing to recognize that this Court, not Congress, has articulated the ground rules for procedural due process in bankruptcy cases. The practice of discharge by declaration is not a means employed by one who is desirous of actually informing a student loan creditor that the issue of dischargeability has been brought into play. Thus, the practice of including "discharge

by declaration" language in chapter 13 plans operates to deny procedural due process to student loan guaranty agencies.

ARGUMENT

USA Funds' brief thoroughly explains why a bankruptcy court confirmation and discharge order which purports to discharge student loan debt without an adjudication of undue hardship is void for exceeding the power and authority granted by Congress to bankruptcy courts in the Bankruptcy Code. This brief will focus on the reasons why the practice of "discharge by declaration" in chapter 13 plans operates to deny procedural due process to student loan guaranty agencies.

CONGRESS EMPOWERED THIS COURT TO ESTABLISH PROCEDURAL DUE PROCESS IN BANKRUPTCY CASES VIA THE BANKRUPTCY RULES

The phrase "after notice and a hearing" appears throughout the Bankruptcy Code as a preface to powers given to debtors to radically reorder contract rights among and between themselves and their creditors. Bankruptcy Code §102(1) explains that this phrase "means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular

circumstances[.]" Bankruptcy jurisdiction in general is *in rem* and this is true for proceedings to determine the dischargeability of a debt by a bankruptcy court. *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004). The rule of construction in Bankruptcy Code §102(1) thus anticipates that due process must be observed in a bankruptcy case before property rights, including dischargeability of claims, may be adjudicated.

The Bankruptcy Code itself never specifies the quantum or manner of giving notice required in any particular context. Instead, Congress empowered this Court, as the ultimate arbiter of what process is due, to specify what manner of notice must be given in each context under the Code. In 28 U.S.C. §2075, this Court is given "the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under Title 11."

In promulgating the Bankruptcy Rules, this Court has broadly distinguished between matters requiring general notice (those affecting the general administration of bankruptcy cases and all creditors generally, but none specifically) and matters requiring service of process (those implicating the rights of specific parties). Bankruptcy Rule 2002 articulates the manner of giving general notice. The subjects covered by Rule 2002 include the date fixed for the meeting of creditors, filing proofs of claim, objections to discharge and objections to a chapter 13 plan. Once a bankruptcy case is filed, all creditors are

charged with notice and a duty of inquiry that these events, which occur in every case, will take place on a specified date. *See Lawrence Tractor v. Gregory* (*In re Gregory*), 708 F.2d 1118, 1123 (9th Cir. 1983).

Bankruptcy Rules 7001 and 9014 govern notice where the rights of specific parties are in dispute. These are events that do not automatically occur in every bankruptcy case. Thus, adversary proceedings and contested matters must be initiated by summons and complaint or motion, and served on the affected creditor at the address of its agent for service of process. *See* FED. R. BANKR. P. 7004 and 9014(b). Taken together, the Bankruptcy Code and Rules were designed to satisfy the due process requirement of adequate notice to parties whose interests may be affected in bankruptcy cases. *See In re Boyken*, 246 B.R. 825, 828 (Bankr. E.D. Va. 2000). As explained by the Fourth Circuit:

> Bankruptcy Rule 2002(b) does not require specific notice of [chapter 13] plan provisions affecting a particular creditor, nor does it require the notice to be served in a particular manner or upon any particular person. 'There are many aspects to and actions that may be taken in bankruptcy cases which affect the general administration of the case and all creditors generally, but none specifically.' . . . generally, such matters require 'notice' but not service of process. . . . When the rights of specific parties become an issue, however, service of the initiating

> motion or objection on the affected party is required. . . . FED. R. BANKR. P. 7003, 7004.

Banks v. Sallie Mae Servicing Corp. (In re Banks), 299 F.3d 296, 301 (4th Cir. 2002) (citations omitted). Thus, when the rights of specific parties become an issue, the Bankruptcy Rules require the debtor to both properly frame the dispute (by complaint or motion) and properly serve the pleading on one authorized to accept service of process for the affected creditor. FED. R. BANKR. P. 7001, 7004 and 9014.

With respect to student loans, Bankruptcy Code §523(a)(8) is "self executing." *Hood*, 541 U.S. at 450. Thus, "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Ibid.* In the Bankruptcy Rules, this Court prescribes that a proceeding to determine the dischargeability of a debt is an adversary proceeding. FED. R. BANKR. P. 7001(6). An adversary proceeding is a civil action commenced by filing a complaint with the bankruptcy court, which is then served, together with a summons, in the manner necessary to effect service of process. FED. R. BANKR. P. 7004. The debtor then must shoulder the burden of proving undue hardship, which is a formidable task.[5]

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[5] In considering whether excepting a student loan from discharge will impose an undue hardship, the majority of courts including those in the Ninth Circuit follow the three-part test first set forth in *Brunner v. New York State Higher Education Services Corp. (In re Brunner)*, 46 B.R. 752 (S.D.N.Y. 1985), aff'd

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These are the building blocks of procedural due process.

THE PRACTICE OF "DISCHARGE BY DECLARATION" IN CHAPTER 13 PLANS VIOLATES PROCEDURAL DUE PROCESS BECAUSE STUDENT LOAN GUARANTY AGENCIES ARE DENIED THE OPPORTUNITY TO PARTICIPATE IN BANKRUPTCY CASES

According to the Fiscal Year 2008 Audited Annual Reports of Chapter 13 Standing Trustees, 323,591 chapter 13 cases were commenced in 2008.[6] This translates into an average of more than 3,442 new chapter 13 cases filed in each judicial district. Because of the magnitude of chapter 13 filings, a natural tension exists between the court's need to efficiently administer these cases while making sure that due process is accorded.

When a debtor with student loans simultaneously files a chapter 13 petition and plan, two complex chains of events are set into concurrent motion: (i) the timetable for objections to and confirmation of the plan; and (ii) the regulatory

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831 F.2d 395 (2nd Cir. 1987). *See United Student Aid Funds, Inc. v. Pena* (*In re Pena*), 155 F.3d 1108 (9th Cir. 1998).

[6] This report can be found at http://www.usdoj.gov/ust/eo/private_trustee/library/chapter13/docs/ch13ar08-AARpt.xls.

response by the student loan lender and guaranty agency.

Chapter 13 plans are frequently filed with the petition, and if not, must be filed within 15 days thereafter per Bankruptcy Rule 3015(b). When the chapter 13 plan is filed with the petition, the plan or a summary of the plan (the "Plan Document") is mailed together with Official Form B9I (the "Initial Notice") to creditors at the address furnished by the debtor with the petition. FED. R. BANKR. P. 3015, 1007(a). In the case of a student loan creditor, the debtor will usually furnish the address to which payments are being mailed – generally, a lockbox service maintained for student loans. The Initial Notice contains the date for the confirmation hearing, the bar date for filing proofs of claim and the date for the first meeting of creditors.

Now for the technical part: Rule 2003(a) specifies that the meeting of creditors in a chapter 13 case shall be held no fewer than 20 and no more than 50 days after the petition date. Bankruptcy Code §1324(b) specifies that the hearing on confirmation of the chapter 13 plan may be held not earlier than 20 days and not later than 45 days after the meeting of creditors. Finally, Bankruptcy Rule 2002(b) specifies that the clerk or some other person as the court may direct shall give all creditors not less than 25 days notice by mail of the date fixed for filing objections to and the hearing to consider confirmation of the chapter 13 plan.

Under Department of Education regulations, the bankruptcy filing triggers another sequence of events. A student loan lender is required to file a bankruptcy claim with the applicable guaranty agency within 30 days of the date it receives notice of the first meeting of creditors, which is included in the Initial Notice. 34 C.F.R. §682.402(g)(2). The lender is not charged with the responsibility for filing objections to the plan. 34 C.F.R. §682.402(i)(2). Instead, the guaranty agency is directed to participate in the chapter 13 case and file any necessary objections to the plan. 34 C.F.R. §682.402(i)(2)(iii). However, because Bankruptcy Rule 2002(b) only requires 25 days notice of the time for filing objections to and the hearing to consider confirmation of a chapter 13 plan, frequently the guaranty agency does not have adequate time to actually participate in any given case. This system practically guarantees that, if discharge by declaration becomes the law of the land, a substantial number of chapter 13 plans will evade detection, regardless of the level of diligence exercised by the guaranty agency.

To illustrate, under the Bankruptcy Code and Rules, a debtor having FFELP loans could file a chapter 13 petition and plan on Tuesday, September 1, 2009. The bankruptcy clerk's office would typically issue the Initial Notice the next day. Pursuant to Bankruptcy Rule 2003(a), the meeting of creditors

could be set as early as Friday, September 25, 2009.[7] This notice might also provide for the hearing to consider confirmation of the debtor's plan to be held on Thursday, October 15, 2009, with objections to confirmation due on September 30, 2009. If the debtor in this hypothetical has student loans which are not defaulted, the debtor will list his lender as a creditor, and will probably use the creditor's address for receipt of payments. The bankruptcy clerk in turn will mail the Initial Notice to this address, pursuant to Rule 2002(g)(2).

The debtor's FFELP lender is required to file a bankruptcy claim with the applicable guaranty agency within 30 days of the date it receives the Initial Notice. 34 C.F.R. §682.402(g)(2). If the lender received the Initial Notice on Thursday, September 3, 2009, the lender would have at least until October 2, 2009 to file a bankruptcy claim with the guaranty agency. By that time, the deadline for objecting to confirmation of the plan – September 30 in this hypothetical – has already passed.

Even if the guaranty agency receives the chapter 13 plan from the lender before the deadline for objections to confirmation, the plan follows no required form. There is no national form of chapter 13

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[7] This hypothetical assumes that the clerk adds three days for mailing pursuant to Bankruptcy Rule 9006(f), even though this rule does not apply to notices, *per se*.

plan. As there are 94 judicial districts in the United States and its territories, there are at least 94 forms of chapter 13 plan. If the plan contains "discharge by declaration" language, there are innumerable ways for this language to be buried therein. This follows because neither the Bankruptcy Code nor Rules provide any good faith basis for debtors to include "discharge by declaration" language in the plan.

"Discharge by declaration" in a chapter 13 plan flouts procedural due process at every turn. The plan bears no resemblance whatsoever to a complaint. A complaint very clearly identifies the plaintiff and defendant, and is designed to pinpoint the controversy between those parties. A chapter 13 plan on the other hand is designed to separate creditors by class, and specify the treatment of each class of claims. The treatment of creditors within classes must be the same, and the debtor may not discriminate unfairly against any class so designated. 11 U.S.C. §§1322(a)(3), (b)(1). These are matters which affect all creditors generally, by class, and thus notice is appropriate via Bankruptcy Rule 2002(b). A chapter 13 plan is not designed to procure adjudication of a discrete evidentiary dispute between the debtor and one of his creditors.

If *Espinosa* is affirmed, student loan guaranty agencies will be subject to deluge by a cornucopia of plan forms, each potentially containing "discharge by declaration" language buried in ways limited only by the imagination of zealous debtors' counsel. Guaranty agencies will be forced to hire new staff to scrutinize

a limitless variety of plans within an arbitrarily short period of time. Regardless of their level of diligence, a significant number of improper plans are bound to evade detection.

As this Court noted in *Hood*, "[c]reditors generally are not entitled to personal service before a bankruptcy court may discharge a debt." 541 U.S. at 451. A chapter 13 plan properly describes the conditions by which the debtor proposes to procure a discharge of general unsecured debts pursuant to Bankruptcy Code §1328, a matter which affects all creditors generally, but none specifically. *Banks*, 299 F.3d at 301. When debtors conceal "discharge by declaration" language in chapter 13 plans, with notice limited to that allowed under Bankruptcy Rule 2002(b), the affected guaranty agency is denied its right to specific notice by service of a summons and complaint.

Thus, the chapter 13 practice of "discharge by declaration" operates to deny procedural due process to student loan guaranty agencies. To accord due process,

> [t]he notice must be of such nature as reasonable to convey the required information, . . . and it must afford a reasonable time for those interested to make an appearance. . . . [W]hen notice is a person's due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the

> [guaranty agency] might reasonably adopt to accomplish it.

Mullane v. Central Hanover Bank & Trust, 339 U.S. 306, 314-15 (1950). The practice of "discharge by declaration" satisfies none of these prerequisites. Most clearly, this practice does not afford student loan guaranty agencies a reasonable time to make their appearance.

To take a real world example, in *Andersen*, the guaranty agency (HEAF) actually filed a belated objection to confirmation, which was denied by the court because it was untimely. In retrospect, this was a glaring sign that the notice procedure in place did not afford the guaranty agency a reasonable time to make its appearance. When the issue arose, the bankruptcy court stated the issue as follows:

> whether a debtor may, by including language in a plan, discharge an otherwise non-dischargeable debt in chapter 13. . . . The real issue is whether the plan provisions here constitute a binding adjudication of hardship.

Andersen v. Higher Education Assistance Foundation (*In re Andersen*), Case No. 96-05277 (Bankr. KS 1997) (Doc. #16 at p. 6). In analyzing this issue, the bankruptcy court rejected Ms. Andersen's argument that *res judicata* operates to bar a determination of dischargeability:

> "a judicial determination of undue hardship requires that the debtor bring an adversary

> proceeding. As the District Court for this district stated: [E]very published decision has uniformly held Section 523(a)(8) to be "self executing." . . . (citations omitted) Debtor had the burden to seek a formal judicial determination of the nondischargeability of her student loans. Language in a plan does not constitute a judicial determination of hardship. HEAF and the other creditors were entitled to a higher level of due process before the confirmation of the plan invokes the concept of res judicata. Congress' clear intent to except student loans from discharge cannot be overcome simply by inserting language into a proposed plan providing a confirmation of the plan constitutes a finding of undue hardship. Because the debtor did not formally seek a determination of dischargeability, the student loan debts are nondischargeable.

Id. at p. 9.

The bankruptcy court's Order in *Andersen* is terse, clear and correct, reflecting a result that appeared to the court to be self-evident. However, on appeal, HEAF did not argue that it lacked adequate notice of Andersen's plan prior to confirmation, leading the Tenth Circuit Bankruptcy Appellate Panel ("BAP") to conclude "that due process has been accorded." *Andersen v. Higher Education Assistance Foundation (In re Andersen)*, 215 B.R. 792, 795 (10th Cir. BAP 1998). The BAP reached this erroneous conclusion by relying on precedent from chapter 11 cases, principally *In re Penrod*, 50 F.3d 459 (7th Cir.

1995). The BAP looked to *Penrod* because Bankruptcy Code §1141 contains language analogous to that found in Bankruptcy Code §1327. Code §1141(a) provides that

> . . . the provisions of a confirmed plan bind the debtor . . . and any creditor . . . whether or not the claim or interest of such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.

Penrod in fact states a well-reasoned analysis of the binding effect of a chapter 11 confirmation order. However, the Tenth Circuit BAP's reliance on *Penrod* and its progeny (215 B.R. at 794) is misplaced in the analysis of chapter 13 "discharge by declaration," because student loan creditors in chapter 13 cases are not accorded time to actually participate.

In *Penrod*, the creditor filed a proof of claim reflecting its lien on the Penrods' hogs. The Penrods did not object to the creditor's claim nor question the validity of its lien. Their plan recognized the creditor's secured claim and provided that it would be paid in full with interest. However, the plan was silent regarding whether the creditor would retain its lien on the Penrods' hogs, post confirmation. After the Penrods' plan was confirmed and went into effect, they sold their hogs for slaughter, without remitting to the creditor proceeds from this sale. The creditor then filed suit in state court, claiming that the Penrods' failure to remit these proceeds violated the security agreement between the parties. The Penrods

responded by asking the court to hold the creditor in contempt for violating the plan confirmation order. 50 F.3d at 461.

The question in *Penrod* was whether the creditor's lien passed through the bankruptcy unaffected. Judge Posner found that it did not, because Bankruptcy Code §1141(c) specifies that "except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors. . . ." *Id.* at 462-63. However, Judge Posner's analysis contains a critical predicate:

> when lien holders participate in a bankruptcy proceeding, and especially in a reorganization, they know that their liens are likely to be affected, and indeed altered. . . .
>
> We have concluded that the default rule for secured creditors who file claims for which provision is made in the plan or reorganization is extinction and is found in the Code itself. Section 1141(c) provides with immaterial exceptions that 'except as provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors. . . . ***This is provided, we emphasize, that the holder of the lien participated in the reorganization. If he did not, his lien would not***

> ***be 'property dealt with by the plan' and so this section would not apply.***

Id. at 462-63 (emphasis added).

There is a critical difference between the typical chapter 11 case and the chapter 13 practice of discharge by declaration. In the typical chapter 11 case, the plan is not filed with the petition. This was certainly true in *Penrod*. The Penrods filed their chapter 11 petition on March 27, 1987.[8] On May 12, 1987, the creditor's predecessor-in-interest (Clinton County Farm Bureau Cooperative) filed its notice of appearance and request for service by its counsel.[9] More than a year later, on May 6, 1988, the Penrods filed their disclosure statement and chapter 11 plan of reorganization. During this interval, the creditor's predecessor-in-interest filed its proof of claim. The bankruptcy court entered an order approving the Penrods' disclosure statement on October 19, 1988, and finally entered an order confirming the Penrods' plan of reorganization on June 21, 1990.

These facts led Judge Posner to conclude that the affected creditor in fact had participated in the Penrods' bankruptcy case. As the secured creditor had filed a notice of appearance and request for service by

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[8] Case No. 87-30501 in the United States Bankruptcy Court for the Northern District of Indiana, of record through the ECF system.

[9] *Id.* at Doc. No. 24 (reflecting the creditor's predecessor-in-interest).

counsel, the Penrods' disclosure statement and plan of reorganization were *served* on its counsel, pursuant to FRCP 5(b) incorporated in Bankruptcy Rule 7005. In the chapter 11 context, where creditors are found to have participated, such creditors will have noted their appearance by counsel, and transmittal of the disclosure statement and plan of reorganization to counsel qualifies as service.

By contrast, student loan guaranty agencies are denied the ability to participate in a chapter 13 case where the debtor proposes a plan containing "discharge by declaration" language. In such a case, the Plan Document is not transmitted in a manner sufficient to qualify as service of process. Moreover, the "rocket docket" endemic to chapter 13 practice simply does not allow sufficient time for a guaranty agency to participate, particularly where "discharge by declaration" language is buried in 94 different forms of chapter 13 Plan Document.

This analysis is completely consistent with this Court's recent decision in *Travelers Indemnity Co. v. Bailey*, 129 S.Ct. 2195 (2009). In *Travelers*, this Court made the following salient observation:

> So long as respondents or those in privity with them were parties to Manville's bankruptcy proceeding, and were given a fair chance to challenge the bankruptcy court's subject-matter jurisdiction, they cannot challenge it now by resisting enforcement of the 1986 orders.

Id. at 2198. In *Travelers*, this Court recognizes the same principal stated by Judge Posner in *Penrod*. Where affected creditors have proper notice of a bankruptcy case and a reasonable time to make their appearance, due process is satisfied. However, where the circumstances demonstrate that an affected creditor has not been accorded proper notice or a reasonable time to make its appearance, then due process is not satisfied. *See American Bank and Trust Company v. Jardine Insurance Services Texas, Inc. (In re Barton Industries, Inc.)*, 104 F.3d 1241, 1245 (10th Cir. 1997).

IN *ESPINOSA* THE NINTH CIRCUIT CONFLATES THE CONCEPTS OF SERVICE AND NOTICE AND IGNORES THE SELF-EXECUTING EXCEPTION OF STUDENT LOANS FROM DISCHARGE

In its analysis, the Ninth Circuit commits the fundamental error of confusing the distinction between service and notice under the Bankruptcy Rules, then manages to lose track of the critical concept that the exception of student loans from discharge is self-executing – all in the same sentence: "when the creditor is ***served*** with notice of the proposed plan, it has a full and fair opportunity to insist on the special procedures ***available*** to student loan creditors by objecting to the plan. . . ." *Espinosa*, 553 F.3d 1193, 1199 (emphasis added).

USA Funds was not served with anything in *Espinosa*. Service implies service of process. Service connotes a summons and complaint or motion which properly frames the evidentiary issue pursuant to Bankruptcy Rule 7003 or 9014(a), which is then served according to Bankruptcy Rule 7004(b)(3) or 9014(b). Here, there was no summons and complaint nor even a motion, and notice was of the garden variety provided in Bankruptcy Rule 2002. The notice received does not qualify as service on USA Funds.

Moreover, the exception of student loan debt from discharge is self-executing. *Hood*, 541 U.S. at 450. The debtor has the burden of securing an undue hardship determination. *Ibid.* To do so, the debtor must file a complaint and serve it on the student loan creditor. These are not "special procedures" which are "available to student loan creditors." Guaranty agencies do not have to opt in and debtors are not allowed to opt out of due process. The Ninth Circuit's suggestion otherwise is impossible to square with *Hood*.

The Ninth Circuit again improperly conflates the concepts of service and notice when it states that:

> the creditor in our case (as in [*Mersmann* and *Whelton*])[10] did get proper notice of the

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[10] *Educational Credit Management Corp. v. Mersmann (In re Mersmann)*, 505 F.3d 1033 (10th Cir. 2007); *Whelton v. Educational Credit Management Corp. (In re Whelton)*, 432 F.3d 150 (2d Cir. 2005).

proposed Chapter 13 plan, and so knew perfectly well that if the plan were approved and satisfied, the debtor would be granted a discharge of the student debt listed in the plan. In our case, the creditor was ***served*** with the 'Notice of Commencement of Case Under Chapter 13 of the Bankruptcy Code, Meeting of Creditors and Fixing of Dates.' Attached to this notice was a copy of the proposed Chapter 13 plan which carried the following prominent warning: "WARNING IF YOU ARE A CREDITOR YOUR RIGHTS MAY BE IMPAIRED BY THIS PLAN." There follows a detailed description of debtor's assets and liabilities, a payment schedule and a great deal of other ***pertinent information***. One section of the plan is entitled "education loan(s)" and lists all of Fund's loans, for a total of $13,250. The plan specifies that this amount should be paid in full, followed by a paragraph stating as follows:

> The amounts claimed by the United Student Loan Aid Funds, Inc., et al. for capitalized interest, penalties and fees shall not be paid for reasons that the same are penalties and not provided for in the loan agreement between the debtor and the lender. The subsequent paragraph provides as follows: 'any amounts or claims for student loans unpaid by this plan shall be discharged.' . . .

Espinosa, 553 F.3d at 1200-201 (emphasis added). Once again, USA Funds did not receive *service* of any pleading. Instead, it received mere notice that a chapter 13 case had been filed along with a plan containing a generic "warning" that if you are a creditor, your rights may be impaired by this plan. Of course, in Espinosa's plan, USA Funds was the *only* creditor, and the improper language effecting a discharge by declaration was buried on page 4.

Moreover, Espinosa's chapter 13 plan did not contain very much "pertinent information" whatsoever. Espinosa's chapter 13 plan is a form document, most of which is completely inapplicable to his bankruptcy case.[11] It is not until page 4 of the plan that the reader uncovers the concealed evidentiary dispute. In reality, Espinosa's entire bankruptcy case was predicated on this provision, which is buried in an improper pleading.

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[11] In fact, Espinosa's chapter 13 plan is a veritable "Pandora's Box" of potential mischief. At Paragraph 4 on Page 2 of the plan, Espinosa purports to nullify liens if specific creditors do not file a proof of claim within seven (7) days of the first scheduled confirmation hearing date. In fact, the notice of commencement of case sets a bar date of April 14, 1993, for filing proofs of claim. This date is one day before the date set for the confirmation hearing. Thus, the plan purports to nullify liens (another dispute governed by Bankruptcy Rule 7001) without proper notice and rewrites the bar date for filing proofs of claim. According to the Ninth Circuit's logic, this apparently is not a problem.

In response to the notice of Espinosa's chapter 13 plan, USA Funds did the only thing it was required to do: it filed a proof of claim. The Bankruptcy Code simply does not allow debtors to declare that their student loans shall be discharged without an adversary proceeding. In fact, Bankruptcy Code §1322(b)(11) forbids "discharge by declaration" of otherwise nondischargeable debts in chapter 13 plans. As the holder of a nondischargeable claim, USA Funds had no duty to even read Espinosa's chapter 13 plan. If there is no duty to read the plan, USA Funds cannot be charged with actual notice of evidentiary disputes buried in the plan.

IN *ESPINOSA* THE NINTH CIRCUIT CONFLATES ACTUAL NOTICE OF THE PLAN WITH ACTUAL NOTICE OF IMPROPER "DISCHARGE BY DECLARATION" LANGUAGE WITHIN THE PLAN

The Ninth Circuit suggests that due process was satisfied in Espinosa's case because USA Funds had actual notice of the "discharge by declaration" in Espinosa's plan:

> Funds here did receive actual notice of his bankruptcy case; we know this both from documents in the record, which show receipt, and the fact that Funds presented a proof of claim. Because 'due process does not require actual notice,' . . . it follows *a fortiori* that actual notice satisfies due process. We find

> the argument that the Constitution requires something *more* than the actual notice strained to the point of the bizarre.

Id. at 1203.

Here, the Ninth Circuit conflates actual notice that a chapter 13 plan had been filed with actual notice that such chapter 13 plan contained improperly concealed language effecting discharge by declaration. Nothing in the Bankruptcy Code or Rules can be fairly read to impose a duty to read a chapter 13 plan on a creditor holding a nondischargeable claim. In fact, a compelling public policy argument suggests that student loan guaranty agencies should not incur costs to review chapter 13 plans. Because student loans are nondischargeable in bankruptcy, the most economical way to administer chapter 13 cases and save taxpayer dollars is to simply file a proof of claim, accept whatever distribution is forthcoming under the debtor's plan, then resume collection after the case concludes. This minimizes the cost of administering the FFELP, maximizes the amount available to be re-loaned under that program and reduces the amount of the government's loss (due to the federal guaranty).

The Ninth Circuit relies on *Lawrence Tractor Co. v. Gregory* (*In re Gregory*), 705 F.2d 1118 (9th Cir. 1983), as support for its flawed analysis. *Gregory* concerned a chapter 13 plan filed by a convicted embezzler on November 8, 1979. At that time, Bankruptcy Code §1328(a) allowed for the discharge

of embezzlement debts. Thus, in the context of *Gregory*, the creditor was no different from any other unsecured creditor whose debt was subject to discharge.

Once a chapter 13 bankruptcy petition is filed, all unsecured creditors are properly charged with knowing all things which occur in every chapter 13 case; for example, that a plan will be filed and there will be a deadline for objections to such plan. Unsecured creditors are also properly charged with knowing what a chapter 13 plan shall provide and what it may provide under Bankruptcy Code §1322. Unsecured creditors are further properly charged with knowing the standards for confirmation of a chapter 13 plan under Bankruptcy Code §1325, including the requirement that the plan be proposed in good faith. 11 U.S.C. §1325(a)(3). These matters occur in every chapter 13 case.

The issue in *Gregory* was whether a convicted embezzler who proposes a chapter 13 plan with zero payment to unsecured creditors is proposing a plan in good faith. The Ninth Circuit was correct in finding that the affected creditor was "under constructive or inquiry notice that its claim may be affected, and it ignores the proceedings to which the notice refers at its peril." *Id.* at 1123. Because every chapter 13 plan must be proposed in good faith, all creditors with notice of the plan are properly charged with knowing this. As such, notice pursuant to Rule 2002 of *Gregory's* chapter 13 plan was adequate.

By contrast, Bankruptcy Code §1328(a) specifically excepts student loans from discharge, and the exception is self-executing. Not all chapter 13 debtors request a determination of whether their student loan debts should be discharged on the basis of undue hardship. Thus, there is no reason for a guaranty agency to presume that the dischargeability of student loans will necessarily arise in a chapter 13 case. Therefore, *Gregory* in fact lends no support to *Espinosa*, and the Ninth Circuit's refusal to call for rehearing *en banc* in this case on the basis that it would thereby be required to consider overruling *Gregory* is simply wrong.

In *Banks,* the Fourth Circuit aptly explained the distinction between actual notice that a chapter 13 plan has been filed (which triggers a duty of inquiry upon general unsecured creditors) with actual notice that a discrete evidentiary dispute has been commenced. Writing for the Fourth Circuit, Senior Judge Baldock (sitting by designation from the Tenth Circuit), provides this explanation:

> Bankruptcy Rule 2002(b) does not require specific notice of plan provisions affecting a particular creditor, nor does it require the notice to be served in any particular manner or upon any particular person. 'There are many aspects to and actions that may be taken in bankruptcy cases which affect the general administration of the case and all creditors generally, but none specifically.' *In re Boyken*, 246 B.R. 825, 828-29 (Bankr. E.D. Va. 2000). Generally such matters

require "notice," but not service of process. *Id.* When the rights of specific parties become an issue, however, service of the initiating motion or objection on the affected party is required. *Id.* FED. R. BANKR. P. 7003, 7004. Mailing the proposed plans, the hearing notice and the confirmation order satisfied the notice requirement under Rule 2002, but not the service and summons requirement of 7004. . . .

The district court properly concluded due process entitles a student loan creditor to specific notice of the Debtor's intent to discharge any portion of the debt. Section 523(a)(8) "explicitly precludes the discharge of the debtor['s] student loan debts absent a showing of undue hardship." The Bankruptcy Code and Rules require debtors to bring an adversary proceeding to establish undue hardship. FED. R. BANKR. P. 7001(6). . . . Initiation of an adversary proceeding requires a summons and service of process under Rule 7004(b). FED. R. BANKR. P. 7003, 7004. Banks failed to initiate an adversary proceeding to establish undue hardship. As a result, ECMC did not receive the requisite notice of Banks' intent to discharge post-petition interest on his student loan debts. For lack of adequate notice, the confirmation and discharge orders discharging the interest are not entitled to preclusive effect.

Id. at 301-02 (citations omitted, in part). In Footnote 4, the Fourth Circuit proceeds to make the following observation:

> We do not today hold that the Constitution in itself requires a summons and a service of process to discharge student loan debt. We merely confirm that where the Bankruptcy Code and Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect.

Ibid. Thus, the Fourth Circuit properly recognized that the Bankruptcy Rules establish procedural due process rights in bankruptcy cases.

THIS COURT HAS ESTABLISHED THE STANDARD FOR PROCEDURAL DUE PROCESS IN BANKRUPTCY CASES BY PROMULGATING THE BANKRUPTCY RULES

The Fifth Amendment to the Constitution does not expressly require a summons and service of process to discharge a student loan debt. However, this Court certainly has authority to articulate the ground rules for procedural due process in bankruptcy cases to ensure that property rights are not deprived without due process of law. The Ninth Circuit failed to grasp this principle when it rejected

the due process analysis from the Fourth, Seventh and Sixth Circuits,[12] stating that

> [w]e find it both wrong and dangerous to hold that the standard for what amounts to constitutionally adequate notice can be changed by legislation.

553 F.3d at 1204. This is the Ninth Circuit's most crucial and fundamental mistake. This Court, not Congress, set the standard for what amounts to constitutionally adequate notice.

Bankruptcy Code §102(1) provides that the phrase "after notice and a hearing means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances. . . ." In Code §102(1), Congress unmistakably co-opts the standard for procedural due process adopted by this Court in *Mullane*:

> An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections. . . . The notice must be of such nature as reasonably to convey the

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[12] *See Banks, Ruehle v. Educational Credit Management Corp. (In re Ruehle)*, 412 F.3d 679 (6th Cir. 2005), *In re Hanson*, 397 F.3d 482 (7th Cir. 2005).

> required information, . . . and it must afford a reasonable time for those interested to make their appearance. . . . But when notice is a person's due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the absentee might adopt to accomplish it.

Id. at 314. Acting pursuant to 11 U.S.C. §2075, this Court has specified "the forms of process, writs, pleadings and motions, and practice and procedure in cases under Title 11" by adopting the Bankruptcy Rules. This clearly articulates the standard for procedural due process in bankruptcy cases.

The practice of burying "discharge by declaration" language in chapter 13 plans by debtors' counsel who know that "a proceeding to determine the dischargeability of a debt" must be brought by adversary proceeding pursuant to Bankruptcy Rule 7001(6), clearly is not a means employed by one who is desirous of actually informing a student loan creditor that the issue of dischargeability has been brought into play. This is especially true of Francisco Espinosa, whose chapter 13 petition listed his student loans as his only debts. If Mr. Espinosa had actually wanted to inform USA Funds that he wished to contest the dischargeability of any part of his student loans, he would have commenced an adversary proceeding by filing a complaint, then served it together with a summons. Espinosa's failure to do this denied due process to USA Funds, and thus the

bankruptcy court's confirmation order is void pursuant to FRCP 60(b)(4) and Bankruptcy Rule 9024.

CONCLUSION

The judgment of the Court of Appeals should be reversed, and the case remanded with instructions to affirm the judgment of the district court.

Respectfully submitted,

STEVEN L. THOMAS, ESQ.
WVSB#3738
KAY CASTO & CHANEY PLLC
Post Office Box 2031
Charleston, West Virginia
25327-2031
(304) 345-8900
Counsel for Amicus Curiae